Notes to the Financial Statements

For the year ended 31 December 2007

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION

Principal activities

China Telecom Corporation Limited (the "Company") and its subsidiaries (hereinafter, collectively referred to as the "Group") are engaged in the provision of wireline telecommunications and related services in Shanghai Municipality, Guangdong Province, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province, Guangxi Zhuang Autonomous Region, Chongqing Municipality, Sichuan Province, Hubei Province, Hunan Province, Hainan Province, Guizhou Province, Yunnan Province, Shaanxi Province, Gansu Province, Qinghai Province, Ningxia Hui Autonomous Region and Xinjiang Uygur Autonomous Region of the People's Republic of China (the "PRC"). The Group offers a comprehensive range of wireline telecommunications services to residential and business customers, including local, domestic long distance and international long distance telephone services, Internet and managed data, leased line, and other related services. In 2007, the Group began to offer leased line and other related services in the Asia Pacific region, and certain countries of South and North America.

The operations of the Group in the mainland PRC are subject to the supervision and regulation by the PRC government. The Ministry of Information Industry, pursuant to the authority delegated to it by the PRC's State Council, is responsible for formulating the telecommunications industry policies and regulations, including the regulation and setting of tariff levels for basic telecommunications services, such as local and long distance telephone services, managed data services, leased line and interconnection arrangements.

Organisation

China Telecommunications Corporation ("China Telecom" and together with its subsidiaries other than the Company referred to as "China Telecom Group") is a state-owned enterprise which is under the supervision and regulation of the Ministry of Information Industry. In November 2001, pursuant to an industry restructuring plan approved by the State Council, China Telecom's wireline telecommunications networks and related operations in 10 northern provinces, municipalities and autonomous regions of the PRC were transferred to China Netcom Group. China Telecom retained the wireline telecommunications networks and related operations of 21 provinces, municipalities and autonomous regions of the PRC, including those of the Company's subsidiaries. In accordance with this industry restructuring plan, China Telecom and China Netcom Group own 70% and 30%, respectively, of the nationwide inter-provincial optic fibers.

Notes to the Financial Statements

For the year ended 31 December 2007

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (CONTINUED)

Organisation (continued)

As part of the reorganisation (the "Restructuring") of China Telecom, the Company was incorporated in the PRC on 10 September, 2002. In connection with the Restructuring, China Telecom transferred to the Company the wireline telecommunications business and related operations in Shanghai Municipality, Guangdong Province, Jiangsu Province and Zhejiang Province together with the related assets and liabilities (the "Predecessor Operations") in consideration for 68,317 million ordinary domestic shares of the Company. The shares issued to China Telecom have a par value of RMB1.00 each and represented the entire registered and issued share capital of the Company at that date.

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 15 December 2003, the Company acquired the entire equity interests in Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited and Sichuan Telecom Company Limited (collectively the "First Acquired Group") and certain network management and research and development facilities from China Telecom for a total purchase price of RMB46,000 million on 31 December 2003 (hereinafter, referred to as the "First Acquisition"). The purchase price consisted of a cash payment of RMB11,000 million and a long-term payable of RMB35,000 million (see Note 14).

Pursuant to the resolution passed by the Company's independent shareholders at an Extraordinary General Meeting held on 9 June 2004, the Company acquired the entire equity interests in Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited (collectively the "Second Acquired Group") from China Telecom for a total purchase price of RMB27,800 million on 30 June 2004 (hereinafter, referred to as the "Second Acquisition"). The purchase price consisted of a cash payment of RMB8,340 million and a long-term payable of RMB19,460 million. On 30 June 2004, the Company repaid RMB4,310 million of this payable amount using the net proceeds from the issuance of new H shares in May 2004 (see Note 14).

Notes to the Financial Statements

For the year ended 31 December 2007

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (CONTINUED)

Organisation (continued)

Pursuant to an equity purchase agreement entered into by the Company with China Telecom on 15 June 2007, the Company acquired the entire equity interests in China Telecom System Integration Co., Ltd. ("CTSI"), China Telecom (Hong Kong) International Limited ("CT (HK)") and China Telecom (Americas) Corporation ("CT Americas") (formerly known as "China Telecom (USA) Corporation") (collectively the "Third Acquired Group") from China Telecom for a total purchase price of RMB1,408 million on 30 June 2007 (hereinafter, referred to as the "Third Acquisition"). The purchase price was fully paid in cash in July 2007.

CTSI is a limited company incorporated in mainland PRC and its principal business is the provision of system integration services, outsourcing services, application software development as well as consultancy services in the PRC. CT (HK) is a limited company incorporated in Hong Kong Special Administrative Region of China and operates in the Asia Pacific Region. CT Americas is a limited company incorporated in the United States of America and operates in certain countries of South America and North America. The principal business of CT (HK) and CT Americas is the provision of leased line and related services for corporate customers including voice wholesale, international private network, cross-border transit connection and Internet data centres.

Hereinafter, the First Acquired Group, the Second Acquired Group and the Third Acquired Group are collectively referred to as the "Acquired Groups".

Basis of presentation

Since the Company and the Acquired Groups were under the common control of China Telecom, the First Acquisition, the Second Acquisition and the Third Acquisition (the "Acquisitions") have been reflected in the accompanying consolidated financial statements as a combination of entities under common control in a manner similar to a pooling-of-interests. Accordingly, the assets and liabilities of the Acquired Groups have been accounted for at historical amounts and the consolidated financial statements of the Company include the results of operations and assets and liabilities of the Acquired Groups on a combined basis as of the earliest date presented. The consideration paid by the Company for the acquisition of the Acquired Groups have been accounted for as equity transactions in the consolidated statement of changes in equity.

Notes to the Financial Statements

For the year ended 31 December 2007

1. PRINCIPAL ACTIVITIES, ORGANISATION AND BASIS OF PRESENTATION (CONTINUED)

Basis of presentation (continued)

The results of operations for the year ended 31 December 2006 and the financial condition as at 31 December 2006 previously reported by the Group have been restated to include the results and assets and liabilities of the Third Acquired Group as set out below:

	The Group (as previously reported) RMB millions	The Third Acquired Group RMB millions	The Group (as restated) RMB millions
Result of operations for the year ended 31 December 2006:			
Operating revenues	175,093	523	175,616
Net profit	27,225	99	27,324
Financial condition as at 31 December 2006:			
Total assets	414,041	4,830	418,871
Total liabilities	210,168	1,054	211,222

For the periods presented, all significant balances and transactions between the Group and the Third Acquired Group have been eliminated on combination.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). IFRS includes International Accounting Standards ("IAS") and interpretations. These financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

These financial statements are prepared on the historical cost basis as modified by the revaluation of certain property, plant and equipment (Note 2(g)) and available-for-sale equity securities (Note 2(l)). The accounting policies described below have been consistently applied by the Group.

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgement made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in future financial periods are described in Note 37.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(a) Basis of preparation (continued)

The IASB has issued certain new and revised IFRS which are effective for accounting periods on or after 1 January 2007. The new disclosures resulting from the initial application of these standards or developments to the extent they are relevant to the Group are summarised as follows:

(i) IFRS 7, Financial instruments: Disclosures, requires expanded disclosures about the significance of the Group's financial instruments and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by IAS 32, Financial instruments: Disclosure and presentation. These additional disclosures are provided primarily in Note 32.

(ii) The Amendment to IAS 1, Presentation of financial statements: Capital disclosures, introduces additional disclosure requirements to provide information about the level of capital and the Group's objectives, policies and processes for managing capital. These new disclosures are set out in Note 33.

Both IFRS 7 and the Amendment to IAS 1 do not have any material impact on the classification, recognition and measurement of the amounts recognised in the financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see Note 38).

With effect from 31 December 2007, the Group has presented the amount of "Intangible assets" as a separate caption on the face of the balance sheet. The related comparative figures have been reclassified to conform with the current year's presentation.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Basis of consolidation

The consolidated financial statements comprise the Company and its subsidiaries and the Group's interests in associates. A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases, and the profit attributable to minority interests is separately presented on the face of the consolidated income statement as an allocation of the profit or loss for the year between the minority interests and the equity holders of the Company. Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and consolidated statement of changes in equity within equity, separately from equity attributable to the equity holders of the Company.

An associate is an entity, not being a subsidiary, in which the Group exercises significant influence, but not control, over its management. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

An investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the Group's equity share of the post-acquisition results of the associate.

All significant intercompany balances and transactions and any unrealised gains arising from intercompany transactions are eliminated on consolidation. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Translation of foreign currencies

The functional and presentation currency of the Company and its subsidiaries in mainland PRC is Renminbi ("RMB"). The functional currency of CT (HK) and CT Americas is Hong Kong dollars (HK$) and US dollars (US$) respectively. Foreign currency transactions denominated in currencies other than the functional currency during the year are translated into the functional currency at the applicable rates of exchange prevailing on the transaction dates. Foreign currency monetary assets and liabilities are translated into the functional currency using the applicable exchange rates at the balance sheet date. The resulting exchange differences, other than those capitalised as construction in progress (Note 2(i)), are recognised as income or expense in the consolidated income statement. For the periods presented, no exchange differences were capitalised.

When preparing the Company's consolidated financial statements, the results of operations of CT (HK) and CT Americas are translated into Renminbi at average rate prevailing during the year. Balance sheet items of CT (HK) and CT Americas are translated into Renminbi at the foreign exchange rates ruling at the balance sheet date. The resulting exchange differences are recognised directly in exchange reserve, a component of equity.

(d) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand and time deposits with original maturities of three months or less when purchased. Cash equivalents are stated at cost, which approximates fair value. None of the Group's cash and cash equivalents is restricted as to withdrawal.

(e) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost less allowance for impairment of doubtful debts (Note 2(m)).

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Inventories

Inventories consist of materials and supplies used in maintaining the wireline telecommunications network and goods for resale. Materials and supplies are valued at cost using the first in, first out method, less a provision for obsolescence.

Inventories that are held for resale are stated at the lower of cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

(g) Property, plant and equipment

Property, plant and equipment are initially recorded at cost, less subsequent accumulated depreciation and impairment losses (Note 2(m)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use and the cost of borrowed funds used during the periods of construction. Expenditure incurred after the asset has been put into operation, including cost of replacing part of such an item, is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment and the cost can be measured reliably. All other expenditure, including the cost of repairs and maintenance which is substantially included in network operations and support expenses, is expensed as it is incurred.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Property, plant and equipment (continued)

Subsequent to the revaluation as described in Note 3, property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation, less subsequent accumulated depreciation and impairment losses. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. The separate classes into which the Company groups assets for the revaluation are buildings and improvements; telecommunications network plant and transmission and switching equipment; and furniture, fixture, motor vehicles and other equipment. When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is revalued simultaneously. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to equity under the component of revaluation reserve. However, a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense in the consolidated income statement. However, a revaluation decrease is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Revaluations are performed annually on items which experience significant and volatile movements in fair value while items which experience insignificant movements in fair value are revalued every three years.

Assets acquired under leasing agreements which effectively transfer substantially all the risks and benefits incidental to ownership from the lessor to the lessee are classified as assets under finance leases. Assets held under finance leases are initially recorded at amounts equivalent to the present value of the minimum lease payments (computed using the rate of interest implicit in the lease) which approximate the fair value at the inception of the lease. The net present value of the future minimum lease payments is recorded correspondingly as a finance lease obligation. Assets held under finance leases are amortised over their estimated useful lives on a straight-line basis. As at 31 December 2007, the carrying amount of assets held under finance leases was RMB32 million (2006: RMB197 million).

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(g) Property, plant and equipment (continued)

Gains or losses arising from retirement or disposal of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the consolidated income statement on the date of disposal. On disposal of a revalued asset, the related revaluation surplus is transferred from the revaluation reserve to retained earnings.

Depreciation is provided to write off the cost/revalued amount of each asset over its estimated useful life on a straight-line basis, after taking into account its estimated residual value, as follows:

	Depreciable lives primarily range from
Buildings and improvements	8 to 30 years
Telecommunications network plant, transmission and switching equipment	6 to 10 years
Furniture, fixture, motor vehicles and other equipment	4 to 10 years

Where parts of an item of property, plant and equipment have different useful lives, the cost or valuation of the item is allocated on a reasonable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value are reviewed annually.

(h) Lease prepayments

Lease prepayments represent land use rights paid to the PRC's land bureau. Land use rights are initially carried at cost and written off on a straight-line basis over the respective periods of the rights which range from 20 years to 70 years.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(i) Construction in progress

Construction in progress represents buildings, telecommunications network plant, transmission and switching equipment and other equipment under construction and pending installation, and is stated at cost less impairment losses (Note 2(m)). The cost of an item comprises direct costs of construction, interest charges, and foreign exchange differences on related borrowed funds to the extent that they are regarded as an adjustment to interest charges, during the periods of construction. Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use.

No depreciation is provided in respect of construction in progress.

(j) Intangible assets

The Group's intangible assets, which represent acquired computer software that is not an integral part of any tangible assets, are initially recorded at cost less subsequent accumulated amortisation and impairment losses (Note 2(m)).

Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives of the intangible assets, which range from 3 to 5 years.

(k) Investments in subsidiaries

In the Company's stand-alone balance sheet, investments in subsidiaries are stated at cost less impairment losses (Note 2(m)).

(l) Investments

Investments in available-for-sale equity securities are carried at fair value with any change in fair value being recognised directly in equity. When these investments are derecognised or impaired, the cumulative gain or loss previously recognised directly in equity is recognised in the consolidated income statement. Investments in equity securities that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost less impairment losses (Note 2(m)).

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(m) Impairment

(i) Impairment of investments in equity securities and impairment losses for trade and other receivables

Investments in equity securities and trade and other receivables are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such evidence exists, the impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows, discounted at the current market rate of return for a similar financial asset where the effect of discounting is material, and is recognised as an expense in the consolidated income statement. Impairment losses for trade and other receivables are reversed through profit and loss if in a subsequent period the amount of the impairment losses decreases. Impairment losses for equity securities are not reversed.

For the years ended 31 December 2006 and 2007, no impairment loss was made for investments in equity securities. For the year ended 31 December 2007, impairment losses for trade and other receivables of RMB1,390 million (2006: RMB1,236 million) were recognised.

(ii) Impairment of long-lived assets

The carrying amounts of the Group's long-lived assets, including property, plant and equipment, intangible assets and lease prepayments are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to the recoverable amount. The amount of the reduction is recognised as an expense in the consolidated income statement. The recoverable amount is the greater of the net selling price and the value in use. When an asset does not generate cash flows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit). In determining the value in use, expected future cash flows generated by the assets are discounted to their present value. For the year ended 31 December 2006 and 2007, no provision for impairment loss was made against the carrying value of long-lived assets.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(m) Impairment (continued)

(ii) Impairment of long-lived assets (continued)

The Group assesses at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist. An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount. A subsequent increase in the recoverable amount of an asset, when the circumstances and events that led to the write-down or write-off cease to exist, is recognised as an income in the consolidated income statement. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or write-off not occurred. For the years presented, no reversal of impairment loss was recognised in the consolidated income statement.

(n) Revenue recognition

The Group's revenues are principally derived from the provision of local, domestic long distance ("DLD") and international long distance ("ILD") telephone services which consist of (i) usage charges for telephone services, which vary depending on the day, the time of day, distance and duration of the telephone call, (ii) a monthly telephone service fee, (iii) service activation and installation fees, and (iv) charges for value-added telecommunications services, such as caller ID services, short messaging services, telephone information services and ring tone services. The Group records wireline service revenues over the periods they are earned as follows:

(i) Revenues derived from local, DLD and ILD telephone usage are recognised as the services are provided.

(ii) Upfront fees received for activation of wireline services and wireline installation charges are deferred and recognised over the expected customer relationship period. The related direct incremental customer acquisition costs are deferred to the extent of the upfront fees and are amortised over the same expected customer relationship period.

(iii) Monthly telephone service fees are recognised in the month during which the telephone services are provided to customers.

(iv) Revenues from sale of prepaid calling cards are recognised as the cards are used by customers.

(v) Revenues derived from value-added and integrated information application services are recognised when the services are provided to customers.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Revenue recognition (continued)

Other related telecommunications service revenues are recognised as follows:

(i) Revenues from the provision of Internet and managed data services are recognised when the services are provided to customers.

(ii) Interconnection fees from domestic and foreign telecommunications operators are recognised when the services are rendered as measured by the minutes of traffic processed.

(iii) Lease income from operating leases is recognised over the term of the lease.

(iv) Sale of customer-end equipment is recognised on delivery of the equipment to customers and when the significant risks and rewards of ownership and title have been transferred to the customers.

(o) Advertising and promotion expense

The costs for advertising and promoting the Group's wireline telecommunications services are expensed as incurred. Advertising and promotion expense, which is included in selling, general and administrative expenses, was RMB10,397 million for the year ended 31 December 2007 (2006: RMB10,520 million).

(p) Net finance costs

Net finance costs comprise interest income on bank deposits, interest expense on borrowings, and foreign exchange gains and losses. Interest income from bank deposits is recognised as it accrues using the effective interest method.

Interest costs incurred in connection with borrowings, calculated using the effective interest method, are expensed as incurred, except to the extent that they are capitalised as being directly attributable to the construction of an asset which necessarily takes a substantial period of time to get ready for its intended use.

(q) Research and development expense

Research and development expenditure is expensed as incurred. For the year ended 31 December 2007, research and development expense was RMB524 million (2006: RMB292 million).

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(r) Employee benefits

The Group's contributions to defined contribution retirement plans administered by the PRC government are recognised as an expense in the consolidated income statement as incurred. Further information is set out in Note 35.

Compensation expense in respect of the stock appreciation rights granted is accrued as a charge to the income statement over the applicable vesting period based on the fair value of the stock appreciation rights. The liability of the accrued compensation expense is re-measured to fair value at each balance sheet date with the effect of changes in the fair value of the liability charged or credited to the consolidated income statement. Further details of the Group's stock appreciation rights scheme are set out in Note 36.

(s) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value recognised in the consolidated income statement over the period of the borrowings, together with any interest, using the effective interest method.

(t) Trade and other payables

Trade and other payables are initially recognised at fair value and thereafter stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(u) Provisions and contingent liabilities

A provision is recognised in the consolidated balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

Notes to the Financial Statements

For the year ended 31 December 2007

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(v) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is calculated on the taxable income for the year by applying the applicable tax rates. Deferred tax is provided using the balance sheet liability method, providing for all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is calculated on the basis of the enacted tax rates that are expected to apply in the period when the asset is realised or the liability is settled. The effect on deferred tax of any changes in tax rates is charged or credited to the consolidated income statement, except for the effect of a change in tax rate on the carrying amount of deferred tax assets and liabilities which were previously charged or credited directly to equity upon initial recognition, in such case the effect of a change in tax rate is also charged or credited to equity.

A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(w) Dividends

Dividends are recognised as a liability in the period in which they are declared.

(x) Segmental reporting

A business segment is a distinguishable component of the Group that is engaged in providing products or services and is subject to risks and rewards that are different from those of other segments. For the periods presented, the Group has one operating segment which is the provision of wireline telecommunications services. No geographical segment information has been presented as the Group's operating activities are substantially carried out in the PRC and less than 10 percent of the Group's operating revenues and profit before taxation were derived from activities outside the PRC. A majority of the Group's assets are located in the PRC and less than 10 percent of the Group's total assets are located outside the PRC.

Notes to the Financial Statements

For the year ended 31 December 2007

3. PROPERTY, PLANT AND EQUIPMENT, NET

The Group:

	Buildings and improvements RMB millions	Telecommunications network plant and equipment RMB millions	Furniture, fixture, motor vehicles and other equipment RMB millions	Total RMB millions
Cost/valuation:				
Balance at 1 January 2006	70,829	485,384	22,069	578,282
Additions	103	746	579	1,428
Transferred from construction in progress	3,259	47,414	1,113	51,786
Disposals	(362)	(13,798)	(1,155)	(15,315)
Reclassification	(83)	3,467	(3,384)	–
Balance at 31 December 2006	73,746	523,213	19,222	616,181
Additions	**177**	**709**	**619**	**1,505**
Transferred from construction in progress	**3,016**	**43,262**	**1,373**	**47,651**
Disposals	**(193)**	**(13,405)**	**(968)**	**(14,566)**
Reclassification	**(23)**	**230**	**(207)**	**–**
Revaluations	**3,739**	**19,405**	**(4)**	**23,140**
Balance at 31 December 2007	**80,462**	**573,414**	**20,035**	**673,911**
Accumulated depreciation and impairment:				
Balance at 1 January 2006	(13,842)	(225,090)	(10,979)	(249,911)
Depreciation charge for the year	(2,943)	(45,298)	(2,493)	(50,734)
Written back on disposal	135	11,642	1,066	12,843
Reclassification	(117)	(1,384)	1,501	–
Balance at 31 December 2006	(16,767)	(260,130)	(10,905)	(287,802)
Depreciation charge for the year	**(3,052)**	**(46,157)**	**(2,240)**	**(51,449)**
Written back on disposal	**78**	**11,568**	**903**	**12,549**
Reclassification	**(69)**	**59**	**10**	**–**
Revaluations	**(161)**	**(20,928)**	**3**	**(21,086)**
Balance at 31 December 2007	**(19,971)**	**(315,588)**	**(12,229)**	**(347,788)**
Net book value at 31 December 2007	**60,491**	**257,826**	**7,806**	**326,123**
Net book value at 31 December 2006	56,979	263,083	8,317	328,379

Notes to the Financial Statements

For the year ended 31 December 2007

3. PROPERTY, PLANT AND EQUIPMENT, NET (CONTINUED)

The Company:

	Buildings and improvements RMB millions	Telecommunications network plant and equipment RMB millions	Furniture, fixture, motor vehicles and other equipment RMB millions	Total RMB millions
Cost/valuation:				
Balance at 1 January 2006	–	326	137	463
Additions	–	3	2	5
Transferred from construction in progress	–	84	9	93
Disposals	–	(21)	(12)	(33)
Reclassification	–	14	(14)	–
Balance at 31 December 2006	–	406	122	528
Additions	**–**	**2**	**4**	**6**
Transferred from construction in progress	**216**	**68**	**69**	**353**
Disposals	**–**	**(40)**	**(14)**	**(54)**
Revaluations	**–**	**32**	**(4)**	**28**
Balance at 31 December 2007	**216**	**468**	**177**	**861**
Accumulated depreciation:				
Balance at 1 January 2006	–	(46)	(69)	(115)
Depreciation charge for the year	–	(49)	(20)	(69)
Written back on disposal	–	15	12	27
Reclassification	–	(5)	5	–
Balance at 31 December 2006	–	(85)	(72)	(157)
Depreciation charge for the year	**(2)**	**(49)**	**(17)**	**(68)**
Written back on disposal	**–**	**25**	**13**	**38**
Revaluations	**–**	**(36)**	**3**	**(33)**
Balance at 31 December 2007	**(2)**	**(145)**	**(73)**	**(220)**
Net book value at 31 December 2007	**214**	**323**	**104**	**641**
Net book value at 31 December 2006	–	321	50	371

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3. PROPERTY, PLANT AND EQUIPMENT, NET (CONTINUED)

In accordance with the Group's accounting policy (Note 2(g)), the property, plant and equipment of the Group as at 31 December 2007 were revalued for each asset class by the Company on a depreciated replacement cost basis. The property, plant and equipment as at 31 December 2007 was revalued at RMB326,123 million. The surplus on revaluation of certain property, plant and equipment totalling RMB4,809 million was credited to the revaluation reserve while the deficit on revaluation of certain property, plant and equipment totalling RMB2,755 million was recognised as an expense for the year ended 31 December 2007.

The following is a summary of the carrying value of the Group's property, plant and equipment before the revaluation and the revalued amounts of these assets as at 31 December 2007:

	Carrying value before the revaluation RMB millions	**Revaluation surplus** RMB millions	**Revaluation Deficit** RMB millions	**Revalued amounts** RMB millions
Buildings and improvements	56,913	3,578	–	60,491
Telecommunications network plant and equipment	259,349	1,231	(2,754)	257,826
Furniture, fixture, motor vehicles and other equipment	7,807	–	(1)	7,806
	324,069	4,809	(2,755)	326,123

4. CONSTRUCTION IN PROGRESS

	The Group RMB millions	**The Company** RMB millions
Balance at 1 January 2006	23,567	156
Additions	46,645	186
Transferred to property, plant and equipment	(51,786)	(93)
Balance at 31 December 2006	18,426	249
Additions	**42,433**	**306**
Transferred to property, plant and equipment	**(47,651)**	**(353)**
Balance at 31 December 2007	**13,208**	**202**

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For the year ended 31 December 2007

5. INTANGIBLE ASSETS

	Computer software	
	The Group	**The Company**
	RMB millions	RMB millions
Cost:		
Balance at 1 January 2006	2,068	50
Additions	1,043	10
Disposals	(161)	–
Balance at 31 December 2006	2,950	60
Additions	**1,620**	**8**
Disposals	**(102)**	**–**
Balance at 31 December 2007	**4,468**	**68**
Accumulated amortisation:		
Balance at 1 January 2006	(762)	(22)
Amortisation charge for the year	(460)	(14)
Written back on disposal	129	–
Balance at 31 December 2006	(1,093)	(36)
Amortisation charge for the year	**(696)**	**(8)**
Written back on disposal	**79**	**–**
Balance at 31 December 2007	**(1,710)**	**(44)**
Net book value at 31 December 2007	**2,758**	**24**
Net book value at 31 December 2006	1,857	24

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6. INVESTMENTS IN SUBSIDIARIES

	The Company	
	2007 RMB millions	2006 RMB millions
Unquoted investments, at cost	**178,642**	177,132

Details of the Company's subsidiaries at 31 December 2007, which principally affected the results of operations and the financial position of the Group, are as follows:

Name of Company	**Type of legal entity**	**Date of incorporation**	**Registered/ Issued capital** (in RMB millions unless otherwise stated)
Shanghai Telecom Company Limited	Limited Company	11 October 2002	15,984
Guangdong Telecom Company Limited	Limited Company	10 October 2002	47,513
Jiangsu Telecom Company Limited	Limited Company	19 October 2002	19,208
Zhejiang Telecom Company Limited	Limited Company	10 October 2002	22,400
Anhui Telecom Company Limited	Limited Company	26 August 2003	3,871
Fujian Telecom Company Limited	Limited Company	28 August 2003	10,364
Jiangxi Telecom Company Limited	Limited Company	18 September 2003	4,523
Guangxi Telecom Company Limited	Limited Company	28 August 2003	4,992
Chongqing Telecom Company Limited	Limited Company	22 August 2003	4,276
Sichuan Telecom Company Limited	Limited Company	28 August 2003	8,123
Hubei Telecom Company Limited	Limited Company	9 March 2004	6,208

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For the year ended 31 December 2007

6. INVESTMENTS IN SUBSIDIARIES (CONTINUED)

Name of Company	Type of legal entity	Date of incorporation	Registered/ Issued capital (in RMB millions unless otherwise stated)
Hunan Telecom Company Limited	Limited Company	12 March 2004	3,574
Hainan Telecom Company Limited	Limited Company	9 March 2004	1,233
Guizhou Telecom Company Limited	Limited Company	12 March 2004	2,801
Yunnan Telecom Company Limited	Limited Company	9 March 2004	3,747
Shaanxi Telecom Company Limited	Limited Company	8 March 2004	3,254
Gansu Telecom Company Limited	Limited Company	10 March 2004	4,515
Qinghai Telecom Company Limited	Limited Company	10 March 2004	965
Ningxia Telecom Company Limited	Limited Company	10 March 2004	795
Xinjiang Telecom Company Limited	Limited Company	11 March 2004	4,660
China Telecom System Integration Co., Limited	Limited Company	13 September 2001	142
China Telecom (Hong Kong) International Limited	Limited Company	25 February 2000	HK$100,000
China Telecom (Americas) Corporation	Limited Company	22 November 2001	US$23 million
China Telecom Best Tone Information Service Co., Limited	Limited Company	15 August 2007	350

All of the above subsidiaries are wholly-owned by the Company and except for CT (HK) and CT Americas, all of the subsidiaries are incorporated in mainland PRC.

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For the year ended 31 December 2007

7. INTERESTS IN ASSOCIATES

	The Group	
	2007	2006
	RMB	RMB
	millions	millions
Share of net assets	**793**	581

The Group's interests in associates are accounted for under the equity method and are individually and in aggregate not material to the Group's financial condition or results of operations for all periods presented. Details of the Group's principal associates are as follows:

Name of company	**Attributable equity interest**	**Principal activities**
Shenzhen Shekou Telecommunications Company Limited	50%	Provision of telecommunications services
Shanghai Information Investment Incorporation	24%	Provision of information technology consultancy services

The above associates are established in the PRC and are not traded on any stock exchange.

8. INVESTMENTS

	The Group	
	2007	2006
	RMB	RMB
	millions	millions
Available-for-sale equity securities	**177**	104
Other unlisted equity investments	**97**	99
	274	203

Unlisted equity investments mainly represent the Group's various interests in PRC private enterprises which are mainly engaged in the provision of information technology services and Internet contents.

Notes to the Financial Statements

For the year ended 31 December 2007

9. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and deferred tax liabilities are attributable to the items set out below:

The Group:

	Assets		Liabilities		Net balance	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Current						
Provisions and impairment losses, primarily for receivables	**557**	540	**–**	–	**557**	540
Non-current						
Property, plant and equipment	**1,205**	589	**(2,222)**	(1,566)	**(1,017)**	(977)
Deferred revenues and installation costs	**1,626**	2,152	**(861)**	(1,123)	**765**	1,029
Land use rights	**5,872**	7,690	**–**	–	**5,872**	7,690
Available-for-sale equity securities	**–**	–	**(36)**	(22)	**(36)**	(22)
Deferred tax assets/(liabilities)	**9,260**	10,971	**(3,119)**	(2,711)	**6,141**	8,260

The Group recognises a deferred tax asset only to the extent that it is probable that future taxable income will be available against which the asset can be utilised. Based on the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes that it is probable the Group will realise the benefits of these temporary differences.

Notes to the Financial Statements

For the year ended 31 December 2007

9. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

Movements in temporary differences are as follows:

	Note	Balance at 1 January 2006 RMB millions	Recognised in income statement RMB millions	Recognised in equity RMB millions	Balance at 31 December 2006 RMB millions
Current					
Provisions and impairment losses, primarily for receivables		369	171	–	540
Non-current					
Property, plant and equipment		(885)	(92)	–	(977)
Deferred revenues and installation costs		1,002	27	–	1,029
Land use rights	(i), (iv)	7,867	(182)	5	7,690
Available-for-sale equity securities		–	–	(22)	(22)
Net deferred tax assets		8,353	(76)	(17)	8,260
			(Note 25)		

	Note	**Balance at 1 January 2007 RMB millions**	**Recognised in income statement RMB millions**	**Recognised in equity RMB millions**	**Balance at 31 December 2007 RMB millions**
Current					
Provisions and impairment losses, primarily for receivables		**540**	**17**	**–**	**557**
Non-current					
Property, plant and equipment	(ii), (iii)	**(977)**	**1,024**	**(1,064)**	**(1,017)**
Deferred revenues and installation costs		**1,029**	**(264)**	**–**	**765**
Land use rights	(i), (iii)	**7,690**	**(169)**	**(1,649)**	**5,872**
Available-for-sale equity securities		**(22)**	**–**	**(14)**	**(36)**
Net deferred tax assets		**8,260**	**608**	**(2,727)**	**6,141**
			(Note 25)		

Notes to the Financial Statements

For the year ended 31 December 2007

9. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

Note:

(i) In connection with the Restructuring and the Acquisitions, the land use rights of the Predecessor Operations, the First Acquired Group and the Second Acquired Group were revalued as required by the relevant PRC rules and regulations. The tax bases of the land use rights were adjusted to conform to such revalued amounts. The land use rights were not revalued for financial reporting purposes and accordingly, deferred tax assets were created with corresponding increases in shareholders' equity under the caption of other reserves.

(ii) As described in Note 3, in accordance with the Group's accounting policy, the property, plant and equipment of the Group were revalued as at 31 December 2007. The tax bases of these assets were not adjusted to conform to such revalued amounts and accordingly, a deferred tax asset of RMB646 million and a deferred tax liability of RMB1,136 million in respect of the revaluation deficit and surplus respectively were recognized.

(iii) On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China ("new tax law"), which takes effect on 1 January 2008. According to the new tax law, a unified corporate income tax rate of 25% are applied to PRC entities; however certain entities previously taxed at preferential rates are subject to a transition period during which their tax rate will gradually be increased to the unified rate of 25% over a five year period starting from 1 January 2008.

Based on the new tax law, the income tax rate applicable to the Company and certain of its mainland PRC subsidiaries which were previously taxed at 33% is reduced to 25% from 1 January 2008. Based on a tax notice issued by the State Council on 26 December 2007, the applicable tax rates for entities operating in special economic zones, which were previously taxed at the preferential rate of 15%, are 18%, 20%, 22%, 24% and 25% for the years ending 31 December 2008, 2009, 2010, 2011 and 2012, respectively. According to the same notice, the applicable tax rate for entities operating in the western region of the PRC which were granted a preferential tax rate of 15% from 2004 to 2010, remains at 15% for the years ending 31 December 2008, 2009 and 2010 and will be increased to 25% from 1 January 2011. Accordingly, deferred tax assets that are expected to be recovered and deferred tax liabilities that are expected to be settled after 31 December 2007 were adjusted to reflect the change in tax rate. For deferred tax assets and liabilities which were previously credited or charged to profit and loss upon initial recognition, the overall effect of change in tax rate amounting to RMB112 million was charged to the consolidated income statement. For deferred tax assets and liabilities which previously credited or charged to equity, the overall effect of change in the tax rate amounting to RMB1,577 million was recognised in the consolidated statement of changes in equity.

(iv) The amounts recognised in equity represent the effect of change in tax rate for a subsidiary on the carrying amount of the deferred tax asset which was previously charged to equity.

Notes to the Financial Statements

For the year ended 31 December 2007

10. INVENTORIES

Inventories represent:

	The Group	
	2007	2006
	RMB	RMB
	millions	millions
Materials and supplies	**1,451**	1,770
Goods for resale	**1,212**	1,443
	2,663	3,213

11. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, are analysed as follows:

	The Group		The Company	
	2007	2006	**2007**	2006
	RMB	RMB	**RMB**	RMB
	millions	millions	**millions**	millions
Accounts receivable				
Third parties	**16,560**	15,501	**157**	153
Amounts due from subsidiaries	**–**	–	**46**	69
China Telecom Group	**207**	199	**–**	–
Other state-controlled telecommunications operators in the PRC	**1,377**	1,792	**52**	44
	18,144	17,492	**255**	266
Less: Allowance for impairment of doubtful debts	**(1,434)**	(1,500)	**–**	–
	16,710	15,992	**255**	266

Amounts due from the provision of wireline telecommunications services to residential and business customers are due within 30 days from the date of billing.

Notes to the Financial Statements

For the year ended 31 December 2007

11. ACCOUNTS RECEIVABLE, NET (CONTINUED)

The following table summarises the changes in allowance for impairment of doubtful debts:

	The Group	
	2007 RMB millions	2006 RMB millions
At beginning of year	**1,500**	1,507
Allowance for impairment of doubtful debts	**1,361**	1,224
Accounts receivable written off	**(1,427)**	(1,231)
At end of year	**1,434**	1,500

Ageing analysis of accounts receivable from telephone and Internet subscribers is as follows:

	The Group	
	2007 RMB millions	2006 RMB millions
Current, within 1 month	**10,882**	11,634
1 to 3 months	**2,358**	1,074
4 to 12 months	**1,003**	1,062
More than 12 months	**301**	314
	14,544	14,084
Less: Allowance for impairment of doubtful debts	**(1,304)**	(1,376)
	13,240	12,708

The Company did not have accounts receivable balance from telephone and Internet subscribers.

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For the year ended 31 December 2007

11. ACCOUNTS RECEIVABLE, NET (CONTINUED)

Ageing analysis of accounts receivable from other telecommunications operators and customers is as follows:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Current, within 1 month	**1,660**	1,716	**73**	76
1 to 3 months	**996**	814	**95**	104
4 to 12 months	**468**	546	**47**	80
More than 12 months	**476**	332	**40**	6
	3,600	3,408	**255**	266
Less: Allowance for impairment of doubtful debts	**(130)**	(124)	**–**	–
	3,470	3,284	**255**	266

12. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets represent:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Amounts due from China Telecom Group	**423**	588	**–**	3
Amounts due from subsidiaries	**–**	–	**69,239**	64,919
Amounts due from other state-controlled telecommunications operators in the PRC	**236**	242	**–**	–
Prepayments in connection with construction work and equipment purchases	**850**	742	**88**	–
Prepaid expenses and deposits	**704**	587	**–**	1
Other receivables	**538**	397	**10**	12
	2,751	2,556	**69,337**	64,935

Notes to the Financial Statements

For the year ended 31 December 2007

13. CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Cash at bank and in hand	**16,437**	10,762	**2,090**	881
Time deposits with original maturity within three months	**3,947**	11,564	**3,724**	7,500
	20,384	22,326	**5,814**	8,381

14. SHORT-TERM AND LONG-TERM DEBT

Short-term debt comprises:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Loans from state-controlled banks – unsecured	**29,325**	35,750	**–**	–
Commercial paper – unsecured	**–**	20,000	**–**	20,000
Loans from China Telecom Group – unsecured	**37,841**	23,826	**10,000**	–
Total short-term debt	**67,166**	79,576	**10,000**	20,000

The weighted average interest rate of the Group's total short-term debt as at 31 December 2007 was 4.4% (2006: 3.7%). As at 31 December 2007, the loans from state-controlled banks bear interest at rates ranging from 4.2% to 5.5% per annum and are repayable within one year; the loans from China Telecom Group bear interest at fixed rates ranging from 2.6% to 5.3% per annum and are repayable within one year.

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14. SHORT-TERM AND LONG-TERM DEBT (CONTINUED)

Long-term debt comprises:

	Interest rates and final maturity	The Group 2007 RMB millions	The Group 2006 RMB millions	The Company 2007 RMB millions	The Company 2006 RMB millions
Bank loans – unsecured					
Renminbi denominated	Interest rates ranging from 5.18% to 7.05% per annum with maturities through 2020	**4,113**	11,039	**–**	–
US Dollars denominated	Interest rates ranging from 1.00% to 7.70% per annum with maturities through 2060	**1,012**	1,320	**–**	–
Japanese Yen denominated	Interest rates ranging from 2.30% to 3.50% per annum with maturities through 2040	**1,768**	2,053	**–**	–
Euro denominated	Interest rates ranging from 2.30% to 9.20% per annum with maturities through 2032	**839**	851	**–**	–
Other currencies denominated		**71**	84	**–**	–
		7,803	15,347	**–**	–
Other loans – unsecured					
Renminbi denominated		**6**	2	**–**	–
Amount due to China Telecom – unsecured					
In connection with the First Acquisition – Renminbi denominated (Note (i))		**15,000**	15,000	**15,000**	15,000
In connection with the Second Acquisition – Renminbi denominated (Note (ii))		**15,150**	15,150	**15,150**	15,150
Total long-term debt		**37,959**	45,499	**30,150**	30,150
Less: current portion		**(3,811)**	(8,242)	**–**	–
Non-current portion		**34,148**	37,257	**30,150**	30,150

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14. SHORT-TERM AND LONG-TERM DEBT (CONTINUED)

Note:

(i) Represents the deferred consideration payable to China Telecom in respect of the First Acquisition (Note 1). The amount bears interest on the outstanding balance at 5.184% per annum until 31 December 2008. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 31 December 2013 and the Company may, from time to time, repay all or part of the amount at any time until 31 December 2013 without penalty. In April 2006, the Company repaid RMB10,000 million to China Telecom.

(ii) Represents the remaining balance of the deferred consideration payable to China Telecom in respect of the Second Acquisition (Note 1). The amount bears interest on the outstanding balance at 5.184% per annum until 30 June 2009. Thereafter the interest rate is adjusted based on the prevailing market interest rate. This amount is repayable on 30 June 2014 and the Company may, from time to time, repay all or part of the amount at any time until 30 June 2014 without penalty.

The aggregate maturities of the Group's and the Company's long-term debts subsequent to 31 December 2007 are as follows:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Within 1 year	**3,811**	8,242	**–**	–
Between 1 to 2 years	**699**	3,815	**–**	–
Between 2 to 3 years	**983**	656	**–**	–
Between 3 to 4 years	**190**	246	**–**	–
Between 4 to 5 years	**196**	208	**–**	–
Thereafter	**32,080**	32,332	**30,150**	30,150
	37,959	45,499	**30,150**	30,150

The Group's short-term and long-term debts do not contain any financial covenants. As at 31 December 2007, the Group had available credit facilities of RMB36,823 million (2006: RMB40,268 million) which it can draw upon.

Notes to the Financial Statements

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15. ACCOUNTS PAYABLE

Accounts payable are analysed as follows:

	The Group		The Company	
	2007	2006	**2007**	2006
	RMB millions	RMB millions	**RMB millions**	RMB millions
Third parties	**22,860**	25,709	**92**	61
China Telecom Group	**5,448**	6,583	**18**	8
Other state-controlled telecommunications operators in the PRC	**55**	63	**–**	–
	28,363	32,355	**110**	69

Amounts due to China Telecom Group are repayable in accordance with contractual terms which are similar to those terms offered by third parties.

Ageing analysis of accounts payable is as follows:

	The Group		The Company	
	2007	2006	**2007**	2006
	RMB millions	RMB millions	**RMB millions**	RMB millions
Due within 1 month or on demand	**5,288**	6,115	**22**	–
Due after 1 month but within 3 months	**8,161**	8,831	**11**	45
Due after 3 months but within 6 months	**6,343**	7,181	**7**	9
Due after 6 months	**8,571**	10,228	**70**	15
	28,363	32,355	**110**	69

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16. ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables represent:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Amounts due to China Telecom Group	**915**	1,984	**88**	175
Amounts due to subsidiaries	**–**	–	**14,445**	14,340
Amounts due to other state-controlled telecommunication operators in the PRC	**199**	181	**75**	–
Accrued expenses	**14,272**	13,244	**754**	1,204
Customer deposits and receipts in advance	**14,622**	11,777	**107**	90
Dividend payable	**468**	–	**468**	–
	30,476	27,186	**15,937**	15,809

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17. DEFERRED REVENUES

Deferred revenues represent the unearned portion of upfront connection fees and installation fees received from customers and the unused portion of calling cards. Connection fees and installation fees are amortised over the expected customer relationship period of 10 years. Beginning 1 July 2001, connection fees were no longer collected from new customers.

	The Group	
	2007 RMB millions	2006 RMB millions
Balance at beginning of year	**20,723**	27,708
Additions for the year		
– installation fees	**793**	912
– calling cards	**4,027**	4,204
	4,820	5,116
Reduction for the year		
– amortisation of connection fees	**(3,294)**	(4,971)
– amortisation of installation fees	**(2,735)**	(2,913)
– usage of calling cards	**(4,062)**	(4,217)
Balance at end of year	**15,452**	20,723
Representing:		
– Current portion	**5,629**	7,098
– Non-current portion	**9,823**	13,625
	15,452	20,723

Included in other non-current assets are capitalised direct incremental costs associated with the installation of wireline services. As at 31 December 2007, the unamortised portion of these costs was RMB6,979 million (2006: RMB8,473 million).

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18. SHARE CAPITAL

	The Group and the Company	
	2007	2006
	RMB	RMB
	millions	millions
Registered, issued and fully paid		
67,054,958,321 ordinary domestic shares of RMB1.00 each	**67,055**	67,055
13,877,410,000 overseas listed H shares of RMB1.00 each	**13,877**	13,877
	80,932	80,932

All ordinary domestic shares and H shares rank pari passu in all material respects.

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19. RESERVES

The Group	Capital reserve RMB millions (Note (i))	Share premium RMB millions	Re-valuation reserve RMB millions	Statutory reserves RMB millions (Note (iii))	Other reserves RMB millions (Note (ii))	Exchange reserve RMB millions	Retained earnings RMB millions	Total RMB millions
Balance as at 1 January 2006, as previously reported	(2,804)	10,746	7,451	42,216	7,501	–	35,475	100,585
Adjusted for the Third Acquisition	–	–	–	–	3,387	(170)	–	3,217
Balance as at 1 January 2006, as restated	(2,804)	10,746	7,451	42,216	10,888	(170)	35,475	103,802
Effect of change in tax rate (Note 9)	–	–	–	–	5	–	–	5
Change in fair value of available-for-sale equity securities (net of deferred tax of RMB22 million)	–	–	–	–	44	–	–	44
Exchange difference on translation of financial statements of subsidiaries outside mainland PRC	–	–	–	–	–	(309)	–	(309)
Profit for the year, as restated	–	–	–	–	–	–	27,241	27,241
Deferred tax on revaluation surplus of property, plant and equipment realised	–	–	–	–	33	–	(33)	–
Revaluation surplus realised	–	–	(94)	–	–	–	94	–
Deferred tax on land use rights realised	–	–	–	–	(182)	–	182	–
Dividends (Note 29)	–	–	–	–	–	–	(6,283)	(6,283)
Appropriations (Note (iii))	–	–	–	7,602	–	–	(7,602)	–
Contribution from China Telecom	–	–	–	–	769	–	–	769
Transfer from retained earnings to other reserves	–	–	–	–	99	–	(99)	–
Balance as at 31 December 2006, as restated	(2,804)	10,746	7,357	49,818	11,656	(479)	48,975	125,269
Effect of change in tax rate (Note 9)	**–**	**–**	**–**	**–**	**(1,577)**	**–**	**–**	**(1,577)**
Surplus on revaluation of property, plant and equipment (Note 3)	**–**	**–**	**4,809**	**–**	**–**	**–**	**–**	**4,809**
Deferred tax on revaluation surplus (Note 9)	**–**	**–**	**–**	**–**	**(1,136)**	**–**	**–**	**(1,136)**
Change in fair value of available-for-sale equity securities (net of deferred tax of RMB14 million)	**–**	**–**	**–**	**–**	**64**	**–**	**–**	**64**
Exchange difference on translation of financial statements of subsidiaries outside mainland PRC	**–**	**–**	**–**	**–**	**–**	**(103)**	**–**	**(103)**
Profit for the years	**–**	**–**	**–**	**–**	**–**	**–**	**23,702**	**23,702**
Deferred tax on revaluation surplus of property, plant and equipment realised	**–**	**–**	**–**	**–**	**31**	**–**	**(31)**	**–**
Revaluation surplus realised	**–**	**–**	**(194)**	**–**	**–**	**–**	**194**	**–**
Deferred tax on land use rights realised	**–**	**–**	**–**	**–**	**(169)**	**–**	**169**	**–**
Dividends (Note 29)	**–**	**–**	**–**	**–**	**–**	**–**	**(6,741)**	**(6,741)**
Appropriations (Note (iii))	**–**	**–**	**–**	**5,388**	**–**	**–**	**(5,388)**	**–**
Distribution to China Telecom	**–**	**–**	**–**	**–**	**(2,890)**	**–**	**–**	**(2,890)**
Transfer from retained earnings to other reserves	**–**	**–**	**–**	**–**	**156**	**–**	**(156)**	**–**
Adjustment to statutory reserves (Note (iii))	**–**	**–**	**–**	**(2,839)**	**–**	**–**	**2,839**	**–**
Consideration for the acquisition of the Third Acquired Group (Note 1)	**–**	**–**	**–**	**–**	**(1,408)**	**–**	**–**	**(1,408)**
Balance as at 31 December 2007	**(2,804)**	**10,746**	**11,972**	**52,367**	**4,727**	**(582)**	**63,563**	**139,989**

Notes to the Financial Statements

For the year ended 31 December 2007

19. RESERVES (CONTINUED)

The Company	Capital reserve RMB millions (Note (i))	Share premium RMB millions	Statutory reserves RMB millions (Note (iii))	Retained earnings RMB millions	Total RMB millions
Balance as at 1 January 2006	29,168	10,746	42,216	7,858	89,988
Profit for the year	–	–	–	19,276	19,276
Appropriations (Note (iii))	–	–	7,602	(7,602)	–
Dividends (Note 29)	–	–	–	(6,283)	(6,283)
Balance as at 31 December 2006	29,168	10,746	49,818	13,249	102,981
Profit for the year	**–**	**–**	**–**	**20,455**	**20,455**
Appropriations (Note (iii))	**–**	**–**	**5,388**	**(5,388)**	**–**
Adjustment to statutory reserves (Note (iii))	**–**	**–**	**(2,839)**	**2,839**	**–**
Dividends (Note 29)	**–**	**–**	**–**	**(6,741)**	**(6,741)**
Balance as at 31 December 2007	**29,168**	**10,746**	**52,367**	**24,414**	**116,695**

Note:

(i) Capital reserve of the Group represents the sum of (a) the difference between the carrying amount of the Company's net assets and the par value of the Company's shares issued upon its formation; and (b) the difference between the consideration paid by the Company for the acquired entities under the Acquisitions, which were accounted for as equity transactions as disclosed in Note 1 to the financial statements, and the historical carrying amount of net assets of these acquired entities.

Capital reserve of the Company represents the difference between the carrying amount of the Company's net assets and the par value of the Company's shares issued upon its formation.

(ii) Other reserves of the Group represent primarily the balance of the deferred tax assets resulted from the revaluation of land use rights for tax purposes (and not for financial reporting purposes) as described in Note 9(i) and the balance of the deferred tax liabilities resulted from the revaluation of property, plant and equipment for financial reporting purposes (and not for tax purposes) as described in Note 9(ii).

Notes to the Financial Statements

For the year ended 31 December 2007

19. RESERVES (CONTINUED)

Note: (continued)

(iii) The statutory reserves consist of statutory surplus reserve, discretionary surplus reserve and statutory common welfare fund.

According to the Company's Articles of Association, the Company is required to transfer 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to the statutory surplus reserve until such reserve balance reaches 50% of the registered capital. The transfer to this reserve must be made before distribution of any dividend to shareholders. For the year ended 31 December 2007, the Company transferred RMB2,072 million (2006: RMB2,534 million), being 10% of the year's net profit determined in accordance with the PRC accounting rules and regulations, to this reserve.

On 1 January 2007, the Group adopted the PRC Accounting Standards for Business Enterprises issued by the PRC Ministry of Finance of the PRC on 15 February 2006, which resulted in the statutory surplus reserve being adjusted accordingly.

According to the Company's Articles of Association, the Directors authorised, subject to shareholders' approval, the transfer of RMB3,316 million for the year ended 31 December 2007 (2006: RMB5,068 million), being 16% (2006: 20%) of the year's net profit determined in accordance with the PRC accounting rules and regulations, to the discretionary surplus reserve.

The statutory and discretionary surplus reserves are non-distributable other than in liquidation and can be used to make good of previous years' losses, if any, and may be utilised for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholdings or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issue is not less than 25% of the registered capital.

According to the Company's Articles of Association, the Company was required to transfer 5% to 10% of its net profit, as determined in accordance with the PRC accounting rules and regulations, to a statutory common welfare fund. This fund can only be utilised on capital items for the collective benefits of the Company's employees such as construction of dormitories, canteen and other staff welfare facilities. This fund is non-distributable other than on liquidation. The transfer to this fund must be made before distribution of any dividend to shareholders.

Pursuant to the revision of the PRC Company Law, companies with limited liabilities and companies limited by shares are no longer required to make annual profit appropriation to the statutory common welfare fund commencing on 1 January 2006. The opening balance of the Group's statutory common welfare fund as at 1 January 2006 of RMB7,078 million was transferred to the surplus reserves in accordance with "Notice on accounting issue relating to the implementation of the Company Law of the PRC" issued by the Ministry of Finance.

Notes to the Financial Statements

For the year ended 31 December 2007

19. RESERVES (CONTINUED)

Note: (continued)

(iv) According to the Company's Articles of Association, the amount of retained earnings available for distribution to shareholders of the Company is the lower of the amount determined in accordance with the PRC accounting rules and regulations and the amount determined in accordance with IFRS. At 31 December 2007, the amount of retained earnings available for distribution was RMB24,414 million (2006: RMB13,249 million), being the amount determined in accordance with IFRS. Final dividend of approximately RMB6,279 million in respect of the financial year 2007 proposed after the balance sheet date has not been recognised as a liability at the balance sheet date (Note 29).

20. OPERATING REVENUES

Operating revenues represent revenues from the provision of wireline telecommunications services. The components of the Group's operating revenues are as follows:

		The Group	
	Note	**2007 RMB millions**	2006 RMB millions
Upfront connection fees	(i)	**3,294**	4,971
Upfront installation fees	(ii)	**2,735**	2,913
Monthly fees	(iii)	**25,346**	28,973
Local usage fees	(iv)	**42,343**	46,188
DLD	(iv)	**24,127**	25,517
International, Hong Kong, Macau and Taiwan long distance	(iv)	**2,882**	3,225
Internet	(v)	**31,340**	23,724
Managed data	(vi)	**3,013**	3,080
Interconnections	(vii)	**13,879**	14,095
Leased line	(viii)	**5,321**	4,548
Value-added and integrated information application services	(ix)	**19,231**	14,203
Others	(x)	**5,145**	4,179
		178,656	175,616

Notes to the Financial Statements

For the year ended 31 December 2007

20. OPERATING REVENUES (CONTINUED)

Note:

(i) Represent the amortised amount of the upfront fees received for initial activation of wireline services.

(ii) Represent the amortised amount of the upfront fees received for installation of wireline services.

(iii) Represent amounts charged to customers each month for their use of the Group's telephone services.

(iv) Represent usage fees charged to customers for the provision of telephone services.

(v) Represent amounts charged to customers for the provision of Internet access services.

(vi) Represent amounts charged to customers for the provision of managed data transmission services.

(vii) Represent amounts charged to domestic and foreign telecommunications operators for delivery of voice and data traffic connecting to the Group's wireline telecommunications networks.

(viii) Represent primarily lease income from other domestic telecommunications operators and business customers for the usage of the Group's wireline telecommunications networks.

(ix) Represent amounts charged to customers for provision of wireline value-added services and integrated information application services, which comprise primarily caller ID services, short messaging services, ring tone services, and telephone information services.

(x) Represent primarily revenues from sale, rental and repairs and maintenance of customer-end equipment, and construction of telecommunications network and infrastructure for customers.

Notes to the Financial Statements

For the year ended 31 December 2007

21. PERSONNEL EXPENSES

Personnel expenses are attributable to the following functions:

	The Group	
	2007	2006
	RMB	RMB
	millions	millions
Network operations and support	**17,299**	17,573
Selling, general and administrative	**9,943**	8,637
	27,242	26,210

22. OTHER OPERATING EXPENSES

Other operating expenses consist of:

		The Group	
		2007	2006
		RMB	RMB
	Note	**millions**	millions
Interconnection charges	(i)	**6,760**	6,212
Donations		**54**	23
Others		**43**	20
		6,857	6,255

Note:

(i) Interconnection charges represent amounts incurred for the use of other domestic and foreign telecommunications operators' networks for delivery of voice and data traffic that originate from the Group's wireline telecommunications networks.

Notes to the Financial Statements

For the year ended 31 December 2007

23. TOTAL OPERATING EXPENSES

Total operating expenses for the year ended 31 December 2007 include auditors' remuneration of RMB58 million (2006: RMB61 million).

24. NET FINANCE COSTS

Net finance costs comprise:

	The Group	
	2007	2006
	RMB millions	RMB millions
Interest expense incurred	**5,214**	5,808
Less: Interest expense capitalised*	**(443)**	(716)
Net interest expense	**4,771**	5,092
Interest income	**(366)**	(502)
Foreign exchange losses	**43**	60
Foreign exchange gains	**(148)**	(161)
	4,300	4,489
* Interest expense was capitalised in construction in progress at the following rates per annum	**2.3%-6.7%**	1.9%-5.0%

25. INCOME TAX

Income tax in the consolidated income statement comprises:

	The Group	
	2007	2006
	RMB millions	RMB millions
Provision for PRC income tax	**7,028**	6,668
Provision for income tax in other tax jurisdictions	**32**	15
Deferred taxation (Note 9)	**(608)**	76
	6,452	6,759

Notes to the Financial Statements

For the year ended 31 December 2007

25. INCOME TAX (CONTINUED)

A reconciliation of the expected tax with the actual tax expense is as follows:

		The Group	
	Note	**2007 RMB millions**	2006 RMB millions
Profit before taxation		**30,251**	34,083
Expected income tax expense at statutory tax rate of 33%	(i)	**9,983**	11,247
Differential tax rate on mainland PRC subsidiaries' income	(i)	**(1,678)**	(1,714)
Differential tax rate on other subsidiaries' income	(ii)	**(41)**	(6)
Non-deductible expenses	(iii)	**1,360**	1,210
Non-taxable income	(iv)	**(1,965)**	(2,565)
Effect of change in tax rate	9 (iii)	**112**	–
Tax credit for domestic equipment purchases		**(1,319)**	(1,413)
Income tax		**6,452**	6,759

Note:

(i) The provision for PRC current income tax is based on a statutory rate of 33% of the assessable income of the Company and its subsidiaries in mainland PRC as determined in accordance with the relevant income tax rules and regulations of the PRC, except for certain subsidiaries which are taxed at a preferential rate of 15%.

(ii) Income tax provision of the Company's subsidiaries in the Hong Kong Special Administrative Region of China and other countries is based on the subsidiaries' assessable income and income tax rates applicable in the respective tax jurisdictions which range from 17.5% to 35%.

(iii) Amounts represent personnel and other miscellaneous expenses in excess of statutory deductible limits for tax purpose.

(iv) Amounts primarily represent connection fees received from customers which are not subject to income tax.

Notes to the Financial Statements

For the year ended 31 December 2007

26. DIRECTORS' AND SUPERVISORS' REMUNERATION

The following table sets out the remuneration received or receivable by the Company's directors and supervisors:

	Directors'/ supervisors' fees RMB thousands	Salaries, allowances and benefits in kind RMB thousands	Discretionary bonuses RMB thousands	Retirement scheme contributions RMB thousands	Share-based payments RMB thousands	Total RMB thousands
2007						
Executive directors						
Wang Xiaochu	–	324	1,080	66	513	1,983
Leng Rongquan	–	292	972	60	410	1,734
Wu Andi	–	276	1,127	56	331	1,790
Zhang Jiping	–	276	1,127	55	331	1,789
Huang Wenlin*	–	161	1,013	33	1,962	3,169
Li Ping	–	276	1,127	56	331	1,790
Yang Jie	–	276	1,052	54	410	1,792
Sun Kangmin	–	276	1,052	55	410	1,793
Zhang Chenshuang*	–	115	115	–	–	230
Independent non-executive directors						
Zhang Youcai	150	–	–	–	–	150
Vincent Lo Hong Sui	200	–	–	–	–	200
Shi Wanpeng	150	–	–	–	–	150
Xu Erming	150	–	–	–	–	150
Tse Hau Yin	500	–	–	–	–	500
Supervisors						
Xiao Jinxue^	–	91	202	30	276	599
Zhang Xiuqin^	–	15	147	–	–	162
Li Jian^	–	62	212	19	–	293
Xu Cailiao	–	116	230	38	152	536
Ma Yuzhu	–	184	349	52	249	834
Wang Haiyun^	–	50	56	20	–	126
Independent supervisor						
Zhu Lihao	75	–	–	–	–	75
	1,225	2,790	9,861	594	5,375	19,845

* *Ms Huang Wenlin resigned as an executive director of the Company on 31 August 2007. Mr Zhang Chenshuang was appointed as an executive director of the Company on 31 August 2007.*

^ *Ms Zhang Xiuqin and Mr Li Jian resigned as supervisors in May 2007. Mr Xiao Jinxue and Ms Wang Haiyun were appointed as supervisors of the Company on 29 May 2007.*

Notes to the Financial Statements

For the year ended 31 December 2007

26. DIRECTORS' AND SUPERVISORS' REMUNERATION (CONTINUED)

The following table sets out the remuneration received or receivable by the Company's directors and supervisors:

	Directors'/ supervisors' fees RMB thousands	Salaries, allowances and benefits in kind RMB thousands	Discretionary bonuses RMB thousands	Retirement scheme contributions RMB thousands	Share-based payments RMB thousands	Total RMB thousands
2006						
Executive directors						
Wang Xiaochu	–	324	745	64	–	1,133
Leng Rongquan	–	291	671	58	–	1,020
Wu Andi	–	276	633	54	314	1,277
Zhang Jiping	–	276	633	54	314	1,277
Huang Wenlin	–	276	633	54	314	1,277
Li Ping	–	276	633	54	314	1,277
Wei Leping*	–	108	107	22	162	399
Yang Jie	–	276	633	52	–	961
Sun Kangmin	–	276	633	53	–	962
Independent non-executive directors						
Zhang Youcai	150	–	–	–	–	150
Vincent Lo Hong Sui	200	–	–	–	–	200
Shi Wanpeng	150	–	–	–	–	150
Xu Erming	150	–	–	–	–	150
Tse Hau Yin	500	–	–	–	–	500
Supervisors						
Zhang Xiuqin	–	142	218	50	236	646
Li Jian	–	131	174	40	170	515
Xu Cailiao	–	109	188	36	144	477
Ma Yuzhu	–	173	263	50	236	722
Independent supervisor						
Zhu Lihao	75	–	–	–	–	75
	1,225	2,934	6,164	641	2,204	13,168

* *Mr Wei Leping resigned as an executive director of the Company in May 2006.*

27. INDIVIDUALS WITH HIGHEST EMOLUMENTS

Of the five highest paid individuals of the Group for the years ended 31 December 2007 and 2006, all of them were directors of the Company and whose remuneration was disclosed in Note 26.

None of these employees received any inducements or compensation for loss of office, or waived any emoluments during the periods presented.

28. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company includes a profit of RMB20,455 million (2006: RMB19,276 million) which has been dealt with in the stand-alone financial statements of the Company.

29. DIVIDENDS

Pursuant to a resolution passed at the Directors' meeting on 31 March 2008, a final dividend of equivalent to HK$0.085 per share totalling approximately RMB6,279 million for the year ended 31 December 2007 was proposed for shareholders' approval at the Annual General Meeting. The dividend has not been provided for in the consolidated financial statements for the year ended 31 December 2007.

Pursuant to the shareholders' approval at the Annual General Meeting held on 29 May 2007, a final dividend of RMB0.083302 (equivalent to HK$0.085) per share totalling RMB6,741 million in respect of the year ended 31 December 2006 was declared, of which RMB6,273 million and RMB468 million were paid on 15 June 2007 and 23 January 2008 respectively.

Pursuant to the shareholders' approval at the Annual General Meeting held on 23 May 2006, a final dividend of RMB0.077637 (equivalent to HK$0.075) per share totalling RMB6,283 million in respect of the year ended 31 December 2005 was declared, which was paid on 15 June 2006.

Notes to the Financial Statements

For the year ended 31 December 2007

30. BASIC EARNINGS PER SHARE

The calculation of basic earnings per share for the years ended 31 December 2007 and 2006 is based on the profit attributable to equity holders of the Company of RMB23,702 million and RMB27,241 million, respectively, divided by 80,932,368,321 shares.

The amount of diluted earnings per share is not presented as there were no dilutive potential ordinary shares in existence for all periods presented.

31. COMMITMENTS AND CONTINGENCIES

Operating lease commitments

The Group leases business premises and equipment through non-cancelable operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the rental agreements contain escalation provisions that may require higher future rental payments nor impose restrictions on dividends, additional debt and/or further leasing. The Company does not have significant operating lease commitments.

As at 31 December 2007 and 2006, the Group's future minimum lease payments under non-cancelable operating leases were as follows:

	2007 RMB millions	2006 RMB millions
Within 1 year	**552**	481
Between 1 to 2 years	**369**	320
Between 2 to 3 years	**302**	269
Between 3 to 4 years	**231**	223
Between 4 to 5 years	**184**	172
Thereafter	**383**	329
Total minimum lease payments	**2,021**	1,794

Total rental expense in respect of operating leases charged to the consolidated income statement for the year ended 31 December 2007 was RMB1,716 million (2006: RMB1,383 million).

Notes to the Financial Statements

For the year ended 31 December 2007

31. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Capital commitments

As at 31 December 2007 and 2006, the Group and the Company had capital commitments as follows:

	The Group		The Company	
	2007 RMB millions	2006 RMB millions	**2007 RMB millions**	2006 RMB millions
Authorised and contracted for				
– Properties	**718**	570	**53**	113
– Telecommunications network plant and equipment	**2,855**	2,832	**62**	3
	3,573	3,402	**115**	116
Authorised but not contracted for				
– Properties	**1,005**	1,622	**54**	165
– Telecommunications network plant and equipment	**3,449**	5,590	**24**	6
	4,454	7,212	**78**	171

Contingent liabilities

(a) The Company and the Group were advised by their PRC lawyers that, except for liabilities arising out of or relating to the businesses of the Predecessor Operations and the Acquired Groups transferred to the Company in connection with the Restructuring and the Acquisitions, no other liabilities were assumed by the Company or the Group, and the Company or the Group are not jointly and severally liable for other debts and obligations incurred by China Telecom Group prior to the Restructuring and the Acquisitions.

(b) As at 31 December 2007 and 2006, the Group did not have contingent liabilities in respect of guarantees given to banks in respect of banking facilities granted to other parties, or other forms of contingent liabilities.

Notes to the Financial Statements

For the year ended 31 December 2007

31. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Contingent liabilities (continued)

As at 31 December 2007, the Company's undiscounted maximum amount of potential future payments under guarantees given to banks in respect of banking facilities granted to subsidiaries was RMB1,195 million (2006: RMB1,649 million).

Legal contingencies

The Group is a defendant in certain lawsuits as well as the named party in other proceedings arising in the ordinary course of business. While the outcome of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a material adverse effect on the financial position or operating results of the Group.

32. FINANCIAL INSTRUMENTS

Financial assets of the Group include cash and cash equivalents, time deposits, investments, accounts receivable, amounts due from China Telecom Group, advances and other receivables. Financial liabilities of the Group include short-term and long-term debts, accounts payable, amounts due to China Telecom Group, accrued expenses and other payables. The Group does not hold nor issue financial instruments for trading purposes.

(a) Fair Value

The estimated fair value amounts have been determined by the Group using market information and valuation methodologies considered appropriate. However, considerable judgment is required to interpret market data to develop the estimates of fair values. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Notes to the Financial Statements

For the year ended 31 December 2007

32. FINANCIAL INSTRUMENTS (CONTINUED)

(a) Fair Value (continued)

The fair values of the Group's financial instruments (other than long-term debt and investment securities) approximate their carrying amounts due to the short-term maturity of these instruments. The fair values of long-term indebtedness are estimated by discounting future cash flows using current market interest rates offered to the Group for debt with substantially the same characteristics and maturities. The interest rates used in estimating the fair values of long term debt, having considered the foreign currency denomination of the debt, ranged from 1.5% to 7.047% (2006: 1.5% to 6.156%). As at 31 December 2007 and 2006, the carrying amounts and fair values of the Group's long-term debt were as follows:

	2007		2006	
	Carrying amount RMB millions	**Fair value RMB millions**	Carrying amount RMB millions	Fair value RMB millions
Long-term debt	**37,959**	**35,037**	45,499	43,783

The fair value of available-for-sale equity investment securities, which amounted to RMB177 million as at 31 December 2007 (2006: RMB104 million) was based on quoted market price on a PRC stock exchange. The Group's long-term investments are unlisted equity interests for which no quoted market prices exist in the PRC and accordingly, a reasonable estimate of their fair values could not be made without incurring excessive costs.

Notes to the Financial Statements

For the year ended 31 December 2007

32. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Risks

The Group's financial instruments are exposed to three main types of risks, namely, credit risk, liquidity risk and market risk (which comprises of interest rate risk and foreign currency exchange rate risk). The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. Risk management is carried out under policies approved by the Board of Directors. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as liquidity risk, credit risk, and market risk. The Board regularly reviews these policies and authorizes changes if necessary based on operating and market conditions and other relevant risks. The following summarises the qualitative and quantitative disclosures for each of the three main types of risks:

(i) Credit risk

Credit risk refers to the risk that a counterparty will be unable to pay amounts in full when due. For the Group, this arises mainly from deposits it maintains at financial institutions and credit it provides to residential and corporate customers for the provision of telecommunication services. To limits exposure to credit risk relating to deposits, the Group primarily places cash deposits only with large state-owned financial institution in the PRC with acceptable credit ratings. For accounts receivable, the Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on accounts receivable. Furthermore, the Group has a diversified base of customers with no single customer contributing more than 10% of revenues for the periods presented. Further details of the Group's credit policy for, and quantitative disclosures in respect of the Group's exposure on, credit risk relating to trade receivables are set out in Note 11.

The amounts of cash and cash equivalents, time deposits, accounts receivable and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets.

Notes to the Financial Statements

For the year ended 31 December 2007

32. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Risks (continued)

(ii) Liquidity risk

Liquidity risk refers to the risk that funds will not be available to meet liabilities as they fall due, and results from timing and amount mismatches of cash inflow and outflow. The Group manages liquidity risk by maintaining sufficient cash balances and an adequate amount of committed banking facilities to provide its funding needs, including working capital, principal and interest payments on debts, dividend payments, capital expenditures and new investments for a set minimum period of between 3 to 6 months.

The following table sets out the remaining contractual maturities at the balance sheet date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on prevailing rates at the balance sheet date) and the earliest date the Group would be required to repay:

	2007					
	Carrying amount RMB millions	Total contractual undiscounted cash flow RMB millions	Within 1 year or on demand RMB millions	More than 1 year but less than 2 years RMB millions	More than 2 years but less than 5 years RMB millions	More than 5 years RMB millions
Short-term debt	67,166	(68,644)	(68,644)	–	–	–
Long-term debt	37,959	(48,524)	(5,539)	(2,407)	(6,178)	(34,400)
Accounts payable	28,363	(28,363)	(28,363)	–	–	–
Accrued expenses and other payables	30,476	(30,476)	(30,476)	–	–	–
Income tax payable	3,068	(3,068)	(3,068)	–	–	–
Finance lease obligations	29	(29)	(24)	(5)	–	–
	167,061	(179,104)	(136,114)	(2,412)	(6,178)	(34,400)

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32. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Risks (continued)

(ii) Liquidity risk (continued)

	2006					
	Carrying amount RMB millions	Total contractual undiscounted cash flow RMB millions	Within 1 year or on demand RMB millions	More than 1 year but less than 2 years RMB millions	More than 2 years but less than 5 years RMB millions	More than 5 years RMB millions
Short-term debt	79,576	(81,427)	(81,427)	–	–	–
Long-term debt	45,499	(57,439)	(9,924)	(5,540)	(4,144)	(37,831)
Accounts payable	32,355	(32,355)	(32,355)	–	–	–
Accrued expenses and other payables	27,186	(27,186)	(27,186)	–	–	–
Income tax payable	3,124	(3,124)	(3,124)	–	–	–
Finance lease obligations	48	(48)	(48)	–	–	–
	187,788	(201,579)	(154,064)	(5,540)	(4,144)	(37,831)

(iii) Interest rate risk

The Group's interest rate risk exposure arises primarily from its short-term and long-term debts. Debts carrying interest at variable rates and at fixed rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively. The Group manages its exposure to interest rate risk by maintaining high proportion of fixed rate debts with maturity within one year.

Notes to the Financial Statements

For the year ended 31 December 2007

32. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Risks (continued)

(iii) Interest rate risk (continued)

The following table sets out the interest rate profile of the Group's debt at the balance sheet date.

	2007 Effective Interest Rate %	2007 RMB millions	2006 Effective interest rate %	2006 RMB millions
Fixed rate debt:				
Short-term debt	**4.4**	**67,166**	3.7	79,576
Long-term debt	**3.9**	**7,010**	2.9	13,709
		74,176		93,285
Variable rate debt:				
Long-term debt	**5.2**	**30,949**	5.2	31,790
Total debt		**105,125**		125,075
Fixed rate debt as a percentage of total debt		**70.6%**		74.6%

As at 31 December 2007, it is estimated that an increase of 100 basis points in interest rate, with all other variables held constant, would decrease the Group's net profit for the year and retained earnings by approximately RMB207 million (2006: RMB213 million).

The above sensitivity analysis has been prepared on the assumptions that the change in interest rate had occurred at the balance sheet date and the change was applied to the Group's debt in existence at that date with exposure to cash flow interest rate risk. The analysis is prepared on the same basis for 2006.

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For the year ended 31 December 2007

32. FINANCIAL INSTRUMENTS (CONTINUED)

(b) Risks (continued)

(iv) Foreign currency exchange rate risk

Foreign currency exchange rate risk arises on financial instruments that are denominated in a currency other than the functional currency in which they are measured. The Group's foreign currency risk exposure relates to bank deposits and borrowings denominated primarily in US dollars, Euros, Japanese Yen and Hong Kong dollars.

The Group does not expect the appreciation or depreciation of the Renminbi against foreign currencies will materially affect the Group's financial position and result of operations because 92.6% of the Group's cash and cash equivalents and 96.5% of the Group's short-term and long-term debt as at 31 December 2007 are denominated in Renminbi. Details of bank loans denominated in other currencies are set out in Note 14.

33. CAPITAL MANAGEMENT

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide investment returns for shareholders and benefits for other stakeholders, by pricing products and services commensurately with the level of risk and by securing access to finance at a reasonable cost.

The Group regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position, and makes adjustments to the capital structure in light of changes in economic conditions.

The Group monitors its capital structure on the basis of total debt-to-total assets ratio. For this purpose the Group defines total debt as the sum of short-term debt, long-term debt and finance lease obligations. As at 31 December 2007, the Group's total debt-to-total assets ratio was 25.8% (2006: 29.9%), which is within the range of management's expectation.

Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements.

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control or jointly control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control.

(a) Transactions with China Telecom Group

The Group is a part of a large group of companies under China Telecom, a company owned by the PRC government, and has significant transactions and relationships with members of China Telecom. Because of these relationships, it is possible that the terms of these transactions are not the same as those that would result from transactions among unrelated parties.

The principal transactions with China Telecom Group which were carried out in the ordinary course of business are as follows:

	Note	**2007 RMB millions**	2006 RMB millions
Purchases of telecommunications equipment and materials	(i)	**120**	155
Construction, engineering and information technology services	(ii)	**8,179**	8,216
Provision of community services	(iii)	**2,266**	2,378
Provision of ancillary services	(iv)	**3,574**	3,238
Provision of comprehensive services	(v)	**1,284**	1,143
Operating lease expenses	(vi)	**373**	364
Centralised service expenses	(vii)	**250**	306
Interconnection revenues	(viii)	**139**	179
Interconnection charges	(viii)	**820**	750
Interest on amounts due to and loans from China Telecom Group	(ix)	**2,489**	2,361

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(a) Transactions with China Telecom Group (continued)

Note:

(i) Represent commission paid and payable for procurement services provided by China Telecom Group.

(ii) Represent network construction, engineering and information technology services provided by China Telecom Group.

(iii) Represent amounts paid and payable to China Telecom Group in respect of cultural, educational, hygiene and other community services.

(iv) Represent amounts paid and payable to China Telecom Group in respect of ancillary services such as repairs and maintenance of telecommunications equipment and facilities and certain customer services.

(v) Represent amounts paid and payable to entities of China Telecom Group which were not within the scope of other related party service agreements in respect of services for procurement of telecommunications equipment, network design, software upgrade, system integration and manufacturing of calling cards.

(vi) Represent amounts paid and payable to China Telecom Group for leases of business premises and inter-provincial transmission optic fibres.

(vii) Represent net amount charged by China Telecom Group for costs associated with common corporate services and international telecommunications facilities.

(viii) Represent amounts charged from/to China Telecom for interconnection of domestic long distance telephone calls.

(ix) Represent interest paid and payable to China Telecom Group with respect to the amounts due to China Telecom and loans from China Telecom Group (Note 14).

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(a) Transactions with China Telecom Group (continued)

Amounts due from/to China Telecom Group included in the following balances are summarised as follows:

	2007 RMB millions	2006 RMB millions
Accounts receivable	**207**	199
Prepayments and other current assets	**423**	588
Total amounts due from China Telecom Group	**630**	787
Accounts payable	**5,448**	6,583
Accrued expenses and other payables	**915**	1,984
Short-term debt	**37,841**	23,826
Long-term debt	**30,150**	30,150
Total amounts due to China Telecom Group	**74,354**	62,543

Amounts due from/to China Telecom Group, other than short-term debt and long-term debt, bear no interest, are unsecured and are repayable in accordance with contractual terms which are similar to those terms offered by third parties. The term and conditions associated with short-term debt and long-term debt payable to China Telecom Group are set out in Note 14.

As at 31 December 2007 and 2006, no material allowance for impairment of doubtful debts was recorded in respect of amounts due from China Telecom Group.

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(a) Transactions with China Telecom Group (continued)

On 30 August 2006, the Company entered into a strategic agreement (the "Agreement") with China Communication Services Corporation Limited ("CCS"), a company under the common control of China Telecom. The Agreement was approved by the Company's independent shareholders at an Extraordinary General Meeting held on 25 October 2006. The Agreement is effective from 1 January 2007 to 31 December 2009, pursuant to which the Company's subsidiaries in the Shanghai, Guangdong, Zhejiang, Fujian, Hubei and Hainan regions procure design, construction and engineering services provided by CCS for at least 12.5% of these subsidiaries' annual capital expenditure. In return, CCS agreed to provide an additional price discount of at least 5% for the above services. In addition, the above subsidiaries will also procure facilities management services provided by CCS of not less than RMB1,330 million during the effective period of the Agreement.

As a result of the expansion of services areas of CCS, an amendment to the strategic agreement (the "Supplemental Agreement") was approved by the Company's independent shareholders at an Extraordinary General Meeting held on 7 August 2007. The Supplemental Agreement extends the scope of the Agreement to the Company's subsidiaries in the Jiangsu, Anhui, Jiangxi, Hunan, Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, Qinghai and Xinjiang regions, amends that the Company's subsidiaries will on an annual basis, procure design, construction and engineering services provided by CCS for at least 10.6% of these subsidiaries' annual capital expenditure, and increases the commitment for facilities management services provided by CSS by RMB450 million. The Supplemental Agreement is effective from 1 January 2007 to 31 December 2009.

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(b) Key management personnel compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including directors and supervisors of the Group.

Key management personnel compensation of the Group is summarised as follows:

	2007 RMB millions	2006 RMB millions
Short-term employee benefits	**13,876**	10,323
Post-employment benefits	**594**	641
Equity-based compensation benefits	**5,375**	2,204
	19,845	13,168

The above remuneration is included in personnel expenses.

(c) Contributions to post-employment benefit plans

The Group participates in various defined contribution post-employment benefit plans organised by municipal and provincial governments for its employees. Further details of the Group's post-employment benefit plans are disclosed in Note 35.

(d) Transactions with other state-owned entities in the PRC

The Group is a state-controlled public utilities enterprise and operates in an economic regime currently dominated by entities directly or indirectly controlled by the State through government authorities, agencies, affiliations and other organisations (collectively referred to as "state-controlled entities").

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For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(d) Transactions with other state-owned entities in the PRC (continued)

Apart from transactions with parent company and its affiliates, the Group have transactions with other state-controlled entities which include but not limited to the following:

– sales and purchases of goods, properties and other assets

– rendering and receiving services

– lease of assets

– depositing and borrowing money

– use of public utilities

These transactions are conducted in the ordinary course of the Group's business on terms comparable to the terms of transactions with other entities that are not state-controlled. The Group prices its telecommunications services and products based on government-regulated tariff rates, where applicable, or based on commercial negotiations. The Group has also established its procurement policies and approval processes for purchases of products and services, which do not depend on whether the counterparties are state-controlled entities or not.

Having considered the transactions potentially affected by related party relationships, the entity's pricing strategy, procurement policies and approval processes, and the information that would be necessary for an understanding of the potential effect of the related party relationship on the financial statements, the directors are of the opinion that the following related party transactions require disclosure of numeric details:

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For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(d) Transactions with other state-owned entities in the PRC (continued)

(i) Transactions with other state-controlled telecommunications operators in the PRC

The Group's wireline telecommunications networks interconnect with the networks of other state-controlled telecommunications operators. The Group also leases wireline telecommunications networks to these operators in the normal course of business. The interconnection and leased line charges are regulated by the Ministry of Information Industry. The extent of the Group's interconnection and leased line transactions with other state-controlled telecommunications operators in the PRC is summarised as follows:

	2007 RMB millions	2006 RMB millions
Interconnection revenues	**12,228**	12,035
Interconnection charges	**3,891**	3,405
Leased line revenues	**841**	1,088

Amounts due from/to other state-controlled telecommunications operators in the PRC included in the following balances are summarised as follows:

	2007 RMB millions	2006 RMB millions
Accounts receivable	**1,377**	1,792
Prepayments and other current assets	**236**	242
Total amounts due from other state-controlled telecommunications operators in the PRC	**1,613**	2,034
Accounts payable	**55**	63
Accrued expenses and other payables	**199**	181
Total amounts due to other state-controlled telecommunications operators in the PRC	**254**	244

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(d) Transactions with other state-owned entities in the PRC (continued)

(i) Transactions with other state-controlled telecommunications operators in the PRC (continued)

Amounts due from/to other state-controlled telecommunications operators in the PRC bear no interest, are unsecured and are repayable in accordance with normal commercial terms.

As at 31 December 2007 and 2006, there were no material allowance for impairment of doubtful debts in respect of amounts due from other state-controlled telecommunications operators in the PRC.

(ii) Transactions with state-controlled banks

The Group deposits its cash balances primarily with several state-controlled banks in the PRC and obtains short-term and long-term loans from these banks in the ordinary course of business. The interest rates of these bank deposits and loans are regulated by the People's Bank of China. The Group's interest income earned from deposits with and interest expenses incurred on loans from state-controlled banks in the PRC are as follows:

	2007 RMB millions	2006 RMB millions
Interest income	**360**	450
Interest expense	**2,725**	2,994

Notes to the Financial Statements

For the year ended 31 December 2007

34. RELATED PARTY TRANSACTIONS (CONTINUED)

(d) Transactions with other state-owned entities in the PRC (continued)

(ii) Transactions with state-controlled banks (continued)

The amounts of cash deposited with and loans from state-controlled banks in the PRC are summarised as follows:

	2007 RMB millions	2006 RMB millions
Cash at bank	**16,328**	10,659
Time deposits with maturity within three months	**3,947**	10,484
Time deposits with maturity over three months	**172**	119
Total deposits with state-controlled banks in the PRC	**20,447**	21,262
Short-term loans	**29,325**	35,750
Long-term loans	**7,803**	15,347
Total loans with state-controlled banks in the PRC	**37,128**	51,097

Further details of the interest rates and repayment terms of loans from state-controlled banks are set out in Note 14.

The directors believe the above information provides meaningful disclosure of related party transactions.

Notes to the Financial Statements

For the year ended 31 December 2007

35. POST-EMPLOYMENT BENEFITS PLANS

As stipulated by the regulations of the PRC, the Group participates in various defined contribution retirement plans organised by municipal and provincial governments for its employees. The Group is required to make contributions to the retirement plans at rates ranging from 18% to 20% of the salaries, bonuses and certain allowances of the employees. A member of the plan is entitled to a pension equal to a fixed proportion of the salary prevailing at the member's retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above.

The Group's contributions for the year ended 31 December 2007 were RMB2,537 million (2006: RMB2,376 million).

The amount payable for contributions to defined contribution retirement plans as at 31 December 2007 was RMB560 million (2006: RMB536 million).

36. STOCK APPRECIATION RIGHTS

The Group implemented a stock appreciation rights plan for members of its management to provide incentives to these employees. Under this plan, stock appreciation rights are granted in units with each unit representing one H share. No shares will be issued under the stock appreciation rights plan. Upon exercise of the stock appreciation rights, a recipient will receive, subject to any applicable withholding tax, a cash payment in RMB, translated from the Hong Kong dollar amount equal to the product of the number of stock appreciation rights exercised and the difference between the exercise price and market price of the Company's H shares at the date of exercise based on the applicable exchange rate between RMB and Hong Kong dollar at the date of the exercise. The Company recognises compensation expense of the stock appreciation rights over the applicable vesting period.

In March 2003, the Company's compensation committee approved the granting of 276.5 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights had a contractual life of six years from date of grant and an exercise price of HK$1.48 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 18 months after the date of grant. As at each of the third, fourth, fifth and sixth anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

Notes to the Financial Statements

For the year ended 31 December 2007

36. STOCK APPRECIATION RIGHTS (CONTINUED)

In April 2005, the Company's compensation committee approved the granting of 560.0 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights had a contractual life of six years from date of grant and an exercise price of HK$2.78 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 24 months after the date of grant. As at each of the third, fourth, fifth and six anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

In January 2006, the Company's compensation committee approved the granting of 837.3 million stock appreciation right units to eligible employees. Under the terms of this grant, all stock appreciation rights had a contractual life of six years from date of grant and an exercise price of HK$2.85 per unit. A recipient of stock appreciation rights may not exercise the rights in the first 24 months after the date of grant. As at each of the third, fourth, fifth and six anniversary of the date of grant, the total number of stock appreciation rights exercisable may not in aggregate exceed 25%, 50%, 75% and 100%, respectively, of the total stock appreciation rights granted to such person.

During the year ended 31 December 2007, 204 million (2006: 67 million) stock appreciation right units were exercised. For the year ended 31 December 2007, compensation expense recognised by the Group in respect of stock appreciation rights was RMB689 million (2006: RMB514 million).

As at 31 December 2007, the carrying amount of liability arising from stock appreciation rights was RMB998 million (2006: RMB574 million). As at 31 December 2007 and 2006, all vested stock appreciation rights were exercised.

Notes to the Financial Statements

For the year ended 31 December 2007

37. ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group's financial position and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the consolidated financial statements. The Group bases the assumptions and estimates on historical experience and on other factors that the Group believes to be reasonable and which form the basis for making judgements about matters that are not readily apparent from other sources. On an on-going basis, management evaluates its estimates. Actual results may differ from those estimates as facts, circumstances and conditions change.

The selection of significant accounting policies, the judgements and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing the consolidated financial statements. The significant accounting policies are set forth in Note 2. The Group believes the following significant accounting policies involve the most significant judgements and estimates used in the preparation of the consolidated financial statements.

Revenue recognition for upfront connection and installation fees

The Group defers the recognition of upfront fees for activation of wireline services and wireline installation fees and amortises such fees over the expected customer relationship period of ten years. The related direct incremental customer acquisition costs (including direct costs of installation) are also deferred and amortised over the same expected customer relationship period. The Group estimates the expected customer relationship period based on the historical customer retention experience with consideration of the expected level of future competition, the risk of technological or functional obsolescence of its services, technological innovation, and the expected changes in the regulatory and social environment. If the Group's estimate of the expected customer relationship period changes as a result of increased competition, changes in telecommunications technology or other factors, the amount and timing of recognition of deferred revenue and deferred customer acquisition costs would change for future periods. There have been no changes to the estimated customer relationship period for the years presented.

37. ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Allowance for impairment of doubtful debts

The Group estimates allowance for impairment of doubtful debts resulting from the inability of the customers to make the required payments. The Group bases its estimates on the aging of the accounts receivable balance, customer credit-worthiness, and historical write-off experience. If the financial condition of the customers were to deteriorate, actual write-offs might be higher than expected and could significantly affect the results of future periods.

Impairment on long-lived assets

If circumstances indicate that the carrying amount of a long-lived asset may not be recoverable, the asset may be considered "impaired", and an impairment loss would be recognised in accordance with accounting policy for impairment of long-lived assets as described in Note 2(m). The carrying amounts of long-lived assets are reviewed periodically in order to assess whether the recoverable amounts have declined below the carrying amounts. These assets are tested for impairment whenever events or changes in circumstances indicate that their recorded carrying amounts may not be recoverable. When such a decline has occurred, the carrying amount is reduced to recoverable amount. The recoverable amount is the greater of the net selling price and the value in use. When an asset does not generate cash flows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit). It is difficult to precisely estimate selling price because quoted market prices for the Group's long-lived assets may not be readily available. In determining the value in use, expected future cash flows generated by the asset are discounted to their present value, which requires significant judgement relating to level of revenue and amount of operating costs. The Group uses all readily available information in determining an amount that is a reasonable approximation of recoverable amount, including estimates based on reasonable and supportable assumptions and projections of revenue and amount of operating costs. Changes in these estimates could have a significant impact on the carrying value of the assets and could result in additional impairment charge or reversal of impairment in future periods.

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For the year ended 31 December 2007

37. ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

Depreciation and amortisation

Property, plant and equipment and intangible assets are depreciated on a straight-line basis over the estimated useful lives of the assets, after taking into account their estimated residual value. The Group reviews the estimated useful lives and residual values of the assets annually in order to determine the amount of depreciation expense to be recorded during any reporting period. The useful lives and residual values are based on the Group's historical experience with similar assets and taking into account anticipated technological changes. The depreciation and amortisation expense for future periods is adjusted if there are significant changes from previous estimates.

38. POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE ANNUAL ACCOUNTING PERIOD ENDED 31 DECEMBER 2007

Up to the date of issue of these financial statements, the IASB has issued the following amendments, new standards and interpretations which are not yet effective for the annual accounting period ended 31 December 2007 and which have not been adopted in these financial statements:

	Effective for accounting period beginning on or after
IFRS 8, "Operating segments"	1 January 2009
IAS 1 (September 2007), "Presentation of financial statements"	1 January 2009
IAS 23 (March 2007), "Borrowing costs"	1 January 2009
IFRIC 11, "IFRS 2 – Group and treasury share transactions"	1 March 2007
IFRIC 12, "Service concession arrangements"	1 January 2008
IFRIC 13, "Customer loyalty programmes"	1 July 2008
IFRIC 14, "IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction"	1 January 2008

Management is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far management believes that IFRIC 11, IFRIC 12 and IFRIC 14 are not applicable to the Group's operations and the adoption of the rest of the above amendments, new standards and new interpretations is unlikely to have a significant impact on the Group's results of operations and financial position.

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39. NON-ADJUSTING POST BALANCE SHEET EVENTS

Pursuant to the resolution passed by the Company's shareholders at an Extraordinary General Meeting held on 25 February 2008, the Company entered into merger agreements with each of Shanghai Telecom Company Limited, Guangdong Telecom Company Limited, Jiangsu Telecom Company Limited, Zhejiang Telecom Company Limited, Anhui Telecom Company Limited, Fujian Telecom Company Limited, Jiangxi Telecom Company Limited, Guangxi Telecom Company Limited, Chongqing Telecom Company Limited, Sichuan Telecom Company Limited, Hubei Telecom Company Limited, Hunan Telecom Company Limited, Hainan Telecom Company Limited, Guizhou Telecom Company Limited, Yunnan Telecom Company Limited, Shaanxi Telecom Company Limited, Gansu Telecom Company Limited, Qinghai Telecom Company Limited, Ningxia Telecom Company Limited and Xinjiang Telecom Company Limited, pursuant to which the Company shall merge with these companies. After the merger, the assets, liabilities and operations of these subsidiaries will be transferred to the Company's branches in the respective regions. This merger is an internal reorganisation which has no impact on the Group's consolidated financial condition and results of operations.

Pursuant to an Acquisition Agreement entered into by the Company with China Telecom on 31 March 2008, the Company will acquire the entire equity interest in China Telecom Group Beijing Corporation from China Telecom for a total purchase price of RMB5,557 million (hereinafter, referred to as the "Proposed Acquisition"), subject to approvals by independent shareholders of the Company and relevant government and regulatory authorities. Management believes that the Proposed Acquisition will enhance the Group's market position and competitiveness in mainland PRC. As the Company and China Telecom Group Beijing Corporation are under the common control of China Telecom prior to and after the acquisition, the Proposed Acquisition will be accounted for as a combination of entities under common control in a manner similar to a pooling-of-interests upon completion.

In January and February 2008, various provinces in the PRC were adversely affected by snowstorm and severe weather conditions. Certain property, plant and equipment of the Group were damaged as a result of the adverse weather conditions. Currently, management estimate that such losses, which comprise primarily loss of damaged property, plant and equipment amounted to approximated RMB572 million.

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40. PARENT AND ULTIMATE HOLDING COMPANY

The parent and ultimate holding company of the Group as at 31 December 2007 is China Telecommunications Corporation, a state-owned enterprise established in the PRC. This entity does not produce financial statements available for public use.